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No. 91-512

Supreme Court, U.S.

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In The
Supreme Court of the United States

October Term, 1991

JILL S. KAMEN,

Petitioner,

v.

KEMPER FINANCIAL SERVICES, INC., and
CASH EQUIVALENT FUND, INC.,

Respondent.

Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit

PETITIONER'S REPLY BRIEF

RICHARD M. MEYER
Suite 4915
One Pennsylvania Plaza
New York, New York 10119
(212) 594-5300

Attorney for Petitioner

Of Counsel:

MILBERG WEISS BERSHAD SPECHTRIE & LERACH
One Pennsylvania Plaza
New York, New York 10119

SHEFSKY & FROELICH, LTD.
444 North Michigan Avenue
Chicago, Illinois 60611



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PETITIONER'S REPLY BRIEF

I.

THE COURT OF APPEALS DECIDED A FEDERAL QUESTION IN CONFLICT WITH MARYLAND'S HIGHEST COURT

When this case was before this Court earlier, the Court properly held that, while the content of the demand requirement may be determined by reference to state law, it remains a federal question governed by federal law (App. 18; 111 S. Ct. at 1717):

It is clear that the contours of the demand requirement in a derivative action founded on the ICA are governed by *federal* law. Because the ICA is a federal statute, any common law rule necessary to effectuate a private cause of action under that statute is necessarily federal in character. See *Burks v. Lasker*, 441 U.S., at 476-477, 99 S.Ct., at 1836; *Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173, 176, 63 S.Ct. 172, 173, 87 L.Ed. 165 (1942). [Emphasis in original.]

The Court of Appeals' misinterpretation of Maryland law is thus a federal question. It is not, as respondent contends, "nothing more than a disagreement as to the meaning of state law . . . to which the Court ought not therefore devote its scarce resources." Resp. Br. p. 14. Rather, it is the precise type of question which this Court has expressly recognized in its Rule 10.1(a)¹ (and

¹ Rule 10.1(a) reads, with respect to the character of reasons considered in passing upon certiorari petitions, "When a United States court of appeals . . . has decided a federal question in a way in conflict with a state court of last resort. . . ."

numerous decisions) as being of a cert-worthy character, especially because it determines the enforceability of federal rights.

Review of the decision below is particularly important because the Court of Appeals, misconstruing its function on remand, strained so hard to reach the wrong result, a result which will have far-reaching effects:

1. Despite respondent's disclaimer (Br. pp. 14-15), the Seventh Circuit *did* hold, in direct conflict with *Parish v. Maryland & Virginia Milk Producers Ass'n*, 250 Md. 24, 242 A.2d 512 (1968), *cert. denied*, 404 U.S. 940 (1971), that demand is necessary if the directors are financially disinterested. App. 6.² This holding, if permitted to stand, would completely eliminate shareholder derivative enforcement under the Investment Company Act, since the Act requires all investment companies to have financially disinterested directors. 15 U.S.C. § 80a-10.

2. The complaint alleges that the "non-interested" directors of the Fund were in no position to objectively evaluate a demand because, *inter alia*, they were dependent upon KFS (App. 104). The Petition pointed out (p. 14 n.3) that the Fund's legal counsel, Charles F. Custer, was an interested person. Respondent contends that there is no record support for this assertion, which it brands as "patently false." Resp. Br. p. 4 n.2. The Court is respectfully

² Respondent asserts (Br. p. 17) that the issues involved are nothing more than a particularized application of Maryland law. The Court below, however, held that a demand requirement where directors are financially disinterested is the "prevailing contemporary view." (App. 6).

referred to page 103 of the Joint Appendix in the prior proceeding in this Court (No. 90-516) which sets forth, in a statement filed by the Fund with the SEC, that Mr. Custer is indeed an interested person as defined in the Investment Company Act.

3. This last point, as well as the dispute as to whether the directors committed actionable proxy fraud (compare Pet. p. 13 with Resp. Br. pp. 3 n.2, 12 n.10 and 16), raises the important question of the function of this Court's remand to the Court of Appeals. Respondent claims, as the Court below held, that the fact of remand eliminates the necessity to inquire whether requiring a demand would frustrate the policy of the Investment Company Act. As the Petition demonstrates, that is a distortion of what this Court held. In fact, this Court stated,

Because the Court of Appeals applied a universal-demand rule, it never addressed the sufficiency of petitioner's complaint with reference to the futility exception as defined by the law of Maryland, the State in which the Fund is incorporated. Rather than take the issue up for the first time ourselves, we leave for the Court of Appeals on remand the question whether petitioner adequately *pleaded* excuse of demand for purposes of Rule 23.1.

(App. 32; 111 S. Ct. at 1723 n.10; emphasis supplied.) As noted in *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 542, 544 (1984; concurring opinion of Justice Stevens), "Rule [23.1] concerns itself solely with the adequacy of the pleadings," a requirement which was readily found to be met in that case and is similarly met here. Here, however,

the Court of Appeals undertook to resolve, and resolved incorrectly, the factual issue of the independence of the directors. Under Maryland law, the allegations would have been clearly sufficient; *see* Pet. pp. 10, 12. As respondent notes (Br. p. 5), petitioner requested that the Court of Appeals remand the case to the District Court, where consideration of the factual issues (such as the effects of large compensation and the influence of conflicted counsel) could be appropriately addressed.

4. As noted in the Petition (pp. 5, 14), the Court of Appeals once again imposed its doubts of the value of derivative litigation in concluding that Maryland would be influenced by arguments in favor of a universal demand requirement. Respondent has nothing to say on this score, and its silence is well advised. The Court of Appeals position is untenable.

II.

THE COURT OF APPEALS DECISION IS INCONSISTENT WITH AND FRUSTRATES THE FEDERAL POLICY UNDERLYING SECTION 20 OF THE INVESTMENT COMPANY ACT

Respondent's principal argument with respect to the frustrating effect of the Court of Appeals' decision upon enforcement of Section 20 of the Investment Company Act appears to be that the argument is foreclosed by this Court's remand to the Court of Appeals, a point with which we have dealt above (p. 3; *see also* Pet. pp. 5-6). The Seventh Circuit made no attempt to weigh the requirements of federal policy. The respondent mimics that approach, quoting the *ipse dixit* of the Court below that

"no federal rule prevents the application of Maryland law" (Resp. Br. p. 11 n.8). No attempt has been made either by the Court of Appeals or by the respondent to assess the impact of *J.I. Case Co. v. Borak*, 377 U.S. 426, 434 (1964), which held, with respect to enforcement of the proxy rules, " . . . the overriding federal law applicable here would, where the facts required, control the appropriateness of redress despite the provisions of state corporation law. . . . "

Respondent falsely asserts that petitioner did not raise her federal policy arguments below. Not only did she do so, but she also attached to her position statement a copy of this Court's opinion in which the issue was squarely raised. As noted in the Petition (p. 6), the Court of Appeals dealt with the issue by distorting this Court's holding that the futility exception is not inconsistent with the Investment Company Act, converting that holding to a holding that no federal policy would interfere with the application of a demand requirement.



CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

RICHARD M. MEYER

Suite 4915

One Pennsylvania Plaza

New York, New York 10119

(212) 594-5300

Attorney for Petitioner

Of Counsel:

MILBERG WEISS BERSHAD SPECTHRIE & LERACH

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New York, New York 10119

SHEFSKY & FROELICH, LTD.

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Chicago, Illinois 60611

